

ORIGINAL



0000108254

RECEIVED

2010 MAR -8 P 4:45

AZ CORP COMMISSION  
DOCKET CONTROL

FENNEMORE CRAIG, P.C.  
Jay L. Shapiro (No. 014650)  
Todd C. Wiley (No. 015358)  
3003 N. Central Ave.  
Suite 2600  
Phoenix, Arizona 85012  
Attorneys for Rio Rico Utilities, Inc.

**BEFORE THE ARIZONA CORPORATION COMMISSION**

IN THE MATTER OF THE  
APPLICATION OF RIO RICO  
UTILITIES, INC., AN ARIZONA  
CORPORATION, FOR A  
DETERMINATION OF THE FAIR  
VALUE OF ITS UTILITY PLANTS AND  
PROPERTY AND FOR INCREASES IN  
ITS WATER AND WASTEWATER  
RATES AND CHARGES FOR UTILITY  
SERVICE BASED THEREON.

DOCKET NO: WS-02676A-09-0257

**NOTICE OF FILING WITNESS  
SUMMARIES**

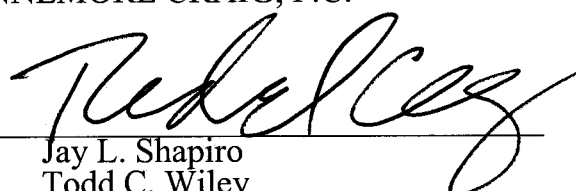
Rio Rico Utilities, Inc. ("RRUI" or "the Company") hereby submits this Notice of Filing in the above-referenced matter. Specifically filed herewith are the summaries of the pre-filed testimony of the following witnesses:

1. Gregory S. Sorensen; and
2. Thomas J. Bourassa.

DATED this 8th day of March, 2010.

FENNEMORE CRAIG, P.C.

By

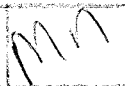
  
Jay L. Shapiro  
Todd C. Wiley  
3003 North Central Avenue  
Suite 2600  
Phoenix, Arizona 85012  
Attorneys for Rio Rico Utilities, Inc.

Arizona Corporation Commission

**DOCKETED**

MAR - 8 2010

DOCKETED BY



1 **ORIGINAL** and thirteen (13) copies  
2 of the foregoing were filed  
3 this 8th day of March, 2010, with:

4 Docket Control  
5 Arizona Corporation Commission  
6 1200 W. Washington St.  
7 Phoenix, AZ 85007

8 **COPY** of the foregoing hand-delivered  
9 this 8th day of March, 2010 to:

10 Chairman Kristin K. Mayes  
11 Arizona Corporation Commission  
12 1200 W. Washington Street  
13 Phoenix, AZ 85007

14 Commissioner Gary Pierce  
15 Arizona Corporation Commission  
16 1200 W. Washington Street  
17 Phoenix, AZ 85007

18 Commissioner Paul Newman  
19 Arizona Corporation Commission  
20 1200 W. Washington Street  
21 Phoenix, AZ 85007

22 Commissioner Sandra D. Kennedy  
23 Arizona Corporation Commission  
24 1200 W. Washington Street  
25 Phoenix, AZ 85007

26 Commissioner Bob Stump  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, AZ 85007

Sheila Stoeller  
Aide to Chairman Kristin K. Mayes  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, AZ 85007

- 1 Antonio Gill  
Aide to Commissioner Gary Pierce  
2 Arizona Corporation Commission  
1200 W. Washington Street  
3 Phoenix, AZ 85007
- 4 Jennifer Ybarra  
Aide to Commissioner Paul Newman  
5 Arizona Corporation Commission  
1200 W. Washington Street  
6 Phoenix, AZ 85007
- 7 Katherine Nutt  
8 Aide to Commissioner Sandra D. Kennedy  
Arizona Corporation Commission  
9 1200 W. Washington Street  
10 Phoenix, AZ 85007
- 11 Trisha Morgan  
Aide to Commissioner Bob Stump  
12 Arizona Corporation Commission  
1200 W. Washington Street  
13 Phoenix, AZ 85007
- 14 Robin Mitchell, Esq.  
Legal Division  
15 Arizona Corporation Commission  
1200 West Washington  
16 Phoenix, Arizona 85007
- 17 Steven M. Olea, Director  
Utilities Division  
18 Arizona Corporation Commission  
1200 West Washington  
19 Phoenix, Arizona 85007
- 20 **COPY** of the foregoing emailed/mailed  
this 8th day of March, 2010 to:
- 21 Jane L. Rodda  
22 Administrative Law Judge  
Hearing Division  
23 Arizona Corporation Commission  
1200 West Washington  
24 Phoenix, Arizona 85007

25

26

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

Michael Patten  
Roshka Heyman & DeWulf, PLC  
One Arizona Center  
400 E. Van Buren St. - 800  
Phoenix, Arizona 85004

Daniel W. Pozefsky, Esq.  
RUCO  
1110 W. Washington St., Suite 220  
Phoenix, Arizona 85007

By: Maria on fire  
2292548.1

**Rio Rico Utilities Inc.**  
**Docket No. WS-02676A-09-0257**

**Greg Sorensen**  
**Testimony Summary**

Mr. Sorensen is employed by Liberty Water, formerly known as Algonquin Water Services, as Director of Operations for the Western Group. He oversees the operations and business management functions for Liberty Water's utility holdings in Arizona, including the Applicant, RRUI. Liberty Water manages and operates 17 utilities in Arizona, Texas, Missouri, and Illinois. Mr. Sorensen has the responsibility for the daily operations of all the Arizona utilities, for the financial operating results for each utility, for capital and operating cost budgeting, for regulatory compliance, planning and oversight as they relate to the operations under his responsibility.

Mr. Sorensen will testify regarding the significant improvements made by the Company to its plant and facilities since the last rate case, and to other changes in revenues and expenses that are contributing to the need for a rate increase for the water division, and a decrease for the wastewater division. Mr. Sorensen will also testify to the Company's low non-account water and the Company's acceptance of Staff's recommended annual filing reflecting that water loss continues to remain under 10 percent.

Finally, Mr. Sorensen will testify regarding two requested changes to RRUI's tariff of rates and charges. First, RRUI proposes a low income tariff modeled after a similar tariff recently approved by the Commission for Chaparral City Water Company. Second, Mr. Sorensen will testify in support of the Company's proposed HUF tariff, which, if approved, will allow RRUI to ensure that growth pays for growth and rates for water and sewer utility service remain within an acceptable range. Mr. Sorensen will discuss the need for the HUF and the potentially unbalanced position that rejecting a HUF could mean for Rio Rico Utilities and its ratepayers. Namely, if the HUF is rejected, additional investment per customer from the utility may be necessary, ultimately resulting in an increase in rates.

**Rio Rico Utilities Inc.**  
**Docket No. WS-02676A-09-0257**

**WITNESS SUMMARY**

**Thomas J. Bourassa**

Thomas J. Bourassa is a Certified Public Accountant who provides consulting services to public utilities. He has testified on numerous occasions before the Arizona Corporation Commission ("the Commission") on behalf of Arizona water and wastewater utilities. In this case he is testifying on behalf of Rio Rico Utilities Inc. ("the Company" or "RRUI") on the topics of the Company's rate base, its income statement (i.e., revenue and operating expenses), its required increase in revenue and its rate design and proposed rates and charges for service. Mr. Bourassa has testified on the cost of capital, including the cost of equity.

**Overview of the Company's Requested Rate Relief**

The Company is requesting a gross revenue increase of \$1,825,426 for its water division, which is an increase of approximately 98.82 percent over test year (December 31, 2008) revenues, and a decrease of \$134,389 for its wastewater division, which is a decrease of approximately -7.34 percent under test year (December 31, 2008) revenues. The following is a summary of the Company's water and wastewater division revenue requirement:

	<u>Water</u>	<u>Wastewater</u>
Fair Value Rate Base	\$ 7,992,279	\$ 3,323,449
Adjusted Operating Income	\$ (185,735)	\$ 471,360
Current Rate of Return	-2.32%	14.18%
Required Operating Income	\$ 935,097	\$ 388,844
Required Rate of Return	11.7%	11.7%
Operating Income Deficiency	\$ 1,120,832	\$ (82,516)
Gross Revenue Conversion Factor	1.6286	1.6286
Increase in Gross Revenues	\$ 1,825,426	\$ (134,389)

There are a number of issues in dispute in this case. The Company has accepted many of the adjustments proposed by Staff and RUCO in order to reduce disputes and simplify the rate case. The following is a brief summary of the major unresolved issues.

### **Rate Base Issues - Water**

1. Deferred Income Taxes ("DIT"). The Company proposes a DIT asset of \$314,965 for the water division. The Company's DIT is based on the requirements of Statement of Financial Standards No. 109 – Accounting for Income Taxes ("FAS 109"). Staff proposes a DIT asset of \$82,782 for the water division. RUCO proposes a DIT liability of \$501,057 for the water division.

2. Accumulated Depreciation - The Company and RUCO are in agreement with an accumulated depreciation balance of \$12,472,661. Staff's proposed accumulated depreciation balance is \$12,423,937 - \$48,724 lower than the Company's balance.

### **Rate Base Issues – Wastewater**

1. Deferred Income Taxes ("DIT"). The Company proposes a DIT asset of \$130,973 for the wastewater division. The Company's DIT is based on the requirements of Statement of Financial Standards No. 109 – Accounting for Income Taxes ("FAS 109"). Staff proposes a DIT asset of \$34,423 for the wastewater division. RUCO proposes a DIT liability of \$208,519 for the wastewater division.

### **Revenue and Income Statement Issues – Water Division**

1. Revenue Annualization. The Company's revenue annualization adjustment for the wastewater division is \$(4,794). Staff is in agreement with the Company. RUCO proposes no revenue annualization adjustment.

2. Contractual Services – Central Office Cost Allocation. The Company includes \$126,794 of allocated Central Office Costs. The Central Office costs are necessary and prudent costs for the operation of RRUI. RUCO reduces Central Office Cost Allocation to \$3,289. Staff reduces the Central Office Cost Allocation to \$2,039.

3. Regulatory Expense - The Company disagrees with Staff's and RUCO's adjustment to regulatory expense for \$17,554. Both Staff and RUCO incorrectly identify these costs as rate case expense related.

4. Rate Case Expense – The Company and Staff agree to rate case expense of \$210,000. RUCO reduces rate case expense by 25 percent. All of the parties agree on a 3 year amortization period.

5. Bad Debt Expense - The Company and RUCO agree to increase bad debt expense by \$799 to \$1,170 based upon a 3 year average annualization. Staff has not adopted this adjustment.

6. Depreciation Expense (CIAC amortization rate) - The Company and RUCO are in agreement on the amortization rate for CIAC. Staff incorrectly computes the CIAC amortization rate using only depreciable plant.

### **Revenue and Income Statement Issues – Wastewater Division**

1. Revenue Annualization. The Company's revenue annualization adjustment for the wastewater division is \$(4,505). Staff is in agreement with the Company. RUCO proposes no revenue annualization adjustment.

2. Contractual Services – Central Office Cost Allocation. The Company includes \$41,822 of allocated Central Office Costs. The Central Office costs are necessary and prudent costs for the operation of RRUI. RUCO reduces Central Office Cost Allocation to \$1,346. Staff reduces the Central Office Cost Allocation to \$688.2.

3. Regulatory Expense - The Company disagrees with Staff's adjustment to regulatory expense for \$994. Staff incorrectly identifies these costs as rate case expense related.

4. Rate Case Expense – The Company and Staff agree to rate case expense of \$125,000. RUCO reduces rate case expense by 25 percent. All of the parties agree on a 3 year amortization period.

5. Bad Debt Expense - The Company and RUCO agree to reduce bad debt expense by \$30,315 to \$33,772 based upon a 3 year average annualization. Staff has not adopted this adjustment.

6. Depreciation Expense (CIAC amortization rate) - The Company and RUCO are in agreement on the amortization rate for CIAC. Staff incorrectly computes the CIAC amortization rate using only depreciable plant.

### **Rate Design and Proposed Rates – Water Division**

The Company proposes an inverted tier rate design which consists of a three tier design for 5/8 inch metered customers and a two tier design for 3/4 inch and larger metered customers. The break-over points are similar among the customer classes and increase with the meter size. Staff and RUCO propose similar designs.

The major area of disagreement with respect to Staff and RUCO's proposed rate designs is that both Staff and RUCO propose monthly minimums that are too low. Staff also proposes a very low 1<sup>st</sup> tier commodity rate. These factors combine to shift revenues away from the monthly minimums to the commodity rates, which will result in more revenue instability.



### **Rate Design and Proposed Rates – Wastewater Division**

The Company's rate design is the same basis rate design currently in effect which primarily reflects a flat rate design for residential and commercial customers. The rate design does contain some charge per rated gallon per day features. Both Staff and RUCO propose rate designs similar to the Company.

### **Cost of Equity and WACC**

Mr. Bourassa performed estimates of the cost of equity using the Commission's preferred models, the Discounted Cash Flow ("DCF") model and the Capital Asset Pricing Model ("CAPM"). Mr. Bourassa's updated estimate of the cost of equity is 11.7 percent. The Company includes a downward financial risk adjustment of 100 basis points and an upward small company risk premium of 50 basis points in arriving at its recommended cost of equity. The Company proposes a 0 percent debt and 100 percent equity capital structure. Accordingly, weighted cost of capital ("WACC") is 11.7 percent.

Staff recommends a 9.2 percent cost of equity. Staff recommends a WACC of 9.2 percent based on a 0 percent debt and 100 percent equity capital structure. Staff's unadjusted cost of equity is 10.3 percent. Staff proposes a 110 basis point reduction to the cost of equity for financial risk. The Company's primary areas of disagreement with Staff concern its growth estimates for the DCF model, its financial risk adjustment, and failure to recognize that RRUI is not directly comparable to the large publicly traded water companies. Staff understates the DCF growth rate because it gives too much weight to historical growth rates. Staff erroneously uses book values in its Hamada method financial risk adjustment computation. The Company believes Staff's financial risk adjustment is overstated by at least 50 basis points. Further, Staff does not consider the higher business and operational risks associated with smaller firms compared to the larger publicly traded firms which would more than offset any financial risk adjustment.

RUCO, in contrast, proposes a WACC of 7.90 percent using a hypothetical capital structure consisting of 40 percent debt and 60 percent equity. RUCO recommends a cost of debt of 6.26 percent and a cost of equity of only 9.00 percent. RUCO also proposes to reduce income taxes using interest synchronization. Ultimately, the effective return on equity based on RUCO proposals is 6.9 percent – far less than the 9.0 percent RUCO recommends.

RUCO used much different inputs to estimate the cost of equity than Staff and the Company. RUCO used different sample water utilities eliminating Connecticut Water Service, Middlesex Water Company and SJW Corporation which are used by both Staff and the Company. RUCO also uses Southwest Water which is not comparable to the Company because less than 50 percent of its revenues are derived from regulated activities and is a financially distressed utility.

RUCO also used a group of publicly traded gas utilities, which depressed the cost of equity. RUCO's gas utility sample has an average beta of 0.67, while RUCO's water utility sample has an average beta of 0.83. Consequently, the gas utilities have substantially less risk and are not directly comparable to the water utilities. To make the gas utilities comparable, an upward risk adjustment of 120 basis points would need to be added to the gas utilities' cost of equity.

RUCO also uses inputs to its CAPM which depress its indicated cost of equity. RUCO DCF results average 9.71 percent. However, the average of RUCO's CAPM results is approximately equal to the cost of debt at 6.1 percent. The current cost of Baa investment grade bonds is 6.3 percent. Further, RUCO's recommended cost of debt for RRUI is 6.26 percent.

2290612.2